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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1946

NO. _____

ENSLEY BANK AND TRUST COMPANY,
Petitioner

vs.

UNITED STATES OF AMERICA,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

May it please the Court:

The petitioner respectfully prays for a writ of certioriari to the United States Circuit Court of Appeals for the Fifth Circuit at New Orleans, Louisiana, to hear this cause and to review the decision of the Circuit Court of Appeals in affirming the judgment of the United States District Court for the Northern District of Alabama, Southern Division. Petitioner respectfully shows to this Honorable Court:

1

SUMMARY STATEMENT OF THE MATTER INVOLVED

There is no dispute as to the facts. Your petitioner was activated in June, 1932 to avert the imminent failure of the Ensley National Bank (hereinafter referred to as "National Bank"). Pursuant to a contract (R. 13) the petitioner assumed National Bank's liabilities in the amount of $355,080.63, (R. 16) and undertook to act as its liquidating agent. (R. 15). National Bank agreed to repay to petitioner $355,080.63, the amount of the liabilities so assumed (R. 17-18; 97-98) and, in addition, to pay the petitioner an amount equivalent to eight per cent (8%) interest on the average daily balance due petitioner on that obligation to repay (R. 18). National Bank pledged its assets to secure its liability to petitioner under the contract (R. 20-21), and it was stipulated that collections on the pledged assets might be applied by petitioner at its election either to repayment of the principal debt due from National Bank, or to payment of the eight per cent (8%) charge. (R. 19).

The petitioner collected substantial sums on sales of the pledged assets. During practically all of 1933, and during the material portion of 1934, the sums so collected were applied by petitioner, first, to payment of its claim to the eight per cent charge, and the balance was applied to payment of the principal debt due from National Bank. (R. 57-61; 102-103).

In the returns filed on the cash receipts and disbursements basis by petitioner for the calendar years 1933 and 1934, the amounts so collected were included in its gross income. (R. 54-55). Petitioner, on said returns, claimed a deduction from its gross income for 1933 in the amount

of $13,039.03, and for 1934 in the amount of $14,318.03, each deduction being claimed on account of a charge-off as worthless of that part of the principal debt due it from National Bank. The Commissioner disallowed the claimed deductions, and assessed additional taxes for each year as a consequence of such disallowance. (R. 55-56).

Petitioner filed claims for refund within the time prescribed by law and, upon the Commissioner's rejection thereof, paid the asserted deficiencies. Petitioner instituted its action in the District Court within two years of the date on which the Commissioner notified petitioner of the rejection of said claims for refund. (R. 102).

In its pleadings in the District Court, and in the briefs filed and arguments made by its Counsel in both the District Court and the Circuit Court of Appeals, the United States defended against petitioner's claim on three grounds. It was urged, first, that the 1932 transaction was not a lending operation but was rather a purchase by petitioner of National Bank's business; second that, even if the 1932 transaction was in some sense a credit operation, yet the claimed deductions for ascertained worthlessness were not available to petitioner since petitioner's liability was asserted to have been that of a guarantor; and, third, the United States argued that, in any event, the claimed deductions were not available to petitioner since National Bank's obligation to repay did not mature until June 19, 1934. The United States did not assert that the petitioner failed to ascertain National Bank's obligation to have been worthless in part. On the contrary, in the answer filed by the United States in the District Court, it is specifically avered that such an ascertainment was made in 1932.

In paragraph 6 (c) of its Complaint filed in the District Court, petitioner alleged as follows:

"From detailed examinations made of its assets by officers of The First National Bank of Birmingham, and by agents of various state and federal banking authorities, the plaintiff had before the end of 1933 determined that the maximum recovery to be expected from the assets pledged to it plus the maximum recovery to be expected from the stockholders of the Ensley National Bank was less than the amount of the debt owed to it by the Ensley National Bank by an amount substantially greater than $13,039.03. The plaintiff, therefore, as of December 30, 1933, charged off on its books $13,039.03 of the debt . . . as worthless and deducted that sum from its gross income as reported. . . ." (R. 5-6).

In paragraph 7 (c) of its said Complaint, a similar allegation was made by petitioner with respect to the amount of $14,318.03 claimed as a deduction in the return filed for the calendar year 1934. (R. 9-10).

The United States, in paragraph VI of the answer filed by it in the District Court, alleged as follows:

". . . As to the allegations in subdivision (c) of paragraph 6 of the bill of complaint, does not deny such allegations except the allegation that plaintiff had before the end of 1933 determined the maximum recovery to be expected from the assets of the said Ensley National Bank pledged to it, but on the contrary specifically avers that any loss plaintiff expected to sustain from the liquidation of said assets was ascertained prior to the year 1933, and, therefore, specifically avers that plaintiff was not entitled under such facts and the law to a deduction of $13,039.03 from gross income as a debt ascertained to be worthless and charged off in the said year 1933. . . ." (R. 46).

In paragraph VII of the said answer, the United States alleged as follows:

". . . does not deny the allegations in subdivisions (a), (b), (c), (d), (e) and (f) of paragraph 7."

In its "Objections by Defendant to Plaintiff's Proposed Conclusions of Law," the United States asserted as follows. (R. 91):

> "The evidence fairly shows that the good will was acquired by plaintiff to make up the difference between the amounts of indebtedness assumed and the amounts expected to be realized out of the liquidation."

There were only these issues presented by the pleadings and the conduct of the trial in the courts below: Did the 1932 transaction give rise to a debtor-creditor relationship, or did it result merely in the acquisition of a capital asset by the petitioner? If the 1932 transaction did give rise to a debtor-creditor relation between petitioner and National Bank, was petitioner's deduction for ascertained worthlessness unavailable because petitioner was a "guarantor," or because National Bank's liability did not mature until July 19, 1934? At no time in the proceedings before either court did counsel for the United States take the position that, even if the 1932 transaction was a lending operation, petitioner nevertheless was not entitled to the deductions claimed in 1933 and 1934 because of a failure to ascertain partial worthlessness in those years. Petitioner demonstrated its positive ascertainment of partial worthlessness in 1933 and 1934 by showing that since some loss on the principal debt was ascertained in 1932, when both possible collections on pledged assets *and* National Bank stockholders' liability were considered, then necessarily an *additional* loss on the principal debt was incurred in 1933 and 1934 when collections made on the pledged assets were applied to payment of petitioners' claim for interest.

The District Court rendered a judgment for petitioner on issues from which the United States took no appeal, and it rendered a judgment against petitioner on the issue as

to good will made by the pleadings, viz, whether or not the 1932 transaction was a lending operation such as is contemplated by the provisions of the Revenue Acts of 1932 and 1934 which authorize the deduction of that portion of a debt ascertained to be worthless and charged-off in the year claimed. The District Court held that your petitioner purchased National Bank's "good will," which was a capital asset such as could give rise to a deduction only upon a subsequent sale for an amount less than petitioner's basis on such asset. The District Court's ninth conclusion of law (R. 109) is as follows:

> "The good will and the business of Ensley National Bank as acquired by plaintiff under the contract was a capital asset. Plaintiff paid for said capital asset the difference between the amount of liabilities assumed and paid under the contract and the amounts realized and collected on liquidation."

The Circuit Court of Appeals' opinion (R. 174) held that the 1932 transaction was such a lending operation as in a proper case might give rise to the deductions claimed for ascertained partial worthlessness. But that court's opinion proceeded to affirm the judgment below on a ground expressly excluded by the pleadings, namely that petitioner failed to ascertain the amount collectible from National Bank's stockholders, and so failed in 1933 and 1934 to ascertain the latter's debt to have been partially worthless. In the course of that opinion, the court said:

> "We do not think the State bank [petitioner] invested $355,000 in this good will, or any measurable sum whatever. It is true that it was a capital asset, and that any gain or loss on it was not realized until it was disposed of in 1935. But we hold that its acquisition under the circumstances does not prevent the note from being a debt. (R. 177-178).

"* * * Appellant [petitioner] argues that it was practically certain in [1933 and 1934] that the note [of National Bank] could not be paid out of the transferred assets, and the witnesses so say; and that when appellant [petitioner] took money from the proceeds of the liquidation each year for its own compensation or interest (creating taxable income for itself) the secured debt was rendered certainly by that much less collectible; and the charge-offs are in each year less than the compensation. The argument would have force, except that the debt was also secured by the stockholders' liabilities of $200,000.00. . . The evidence does not show that it was clearly apparent either in 1933 or 1934 that the transferred assets plus the stockholders' liabilities would not eventually pay the note. A case is not made that the Commissioner arbitrarily refused a partial bad debt deduction to which in the tax years in question the taxpayer was entitled." (R. 178-179).

Petitioner filed its petition for rehearing in due course, on April 18, 1946 (R. 181). In that petition it pointed out that the United States, in its pleadings filed in the District Court, specifically averred that the loss had been ascertained in 1932. (R. 181-183). But the Circuit Court of Appeals, on May 15, 1946, denied the petition for rehearing without opinion. (R. 184).

STATEMENT DISCLOSING BASIS UPON WHICH IT IS CONTENDED THIS COURT HAS JURISDICTION.

Jurisdiction of this cause is conferred upon this Honorable Court by Judicial Code, Section 240, as amended; United States Code, Title 28, Section 347.

The judgment of the Circuit Court of Appeals was entered April 10, 1946 (R. 180), and petitioner's motion for rehearing was denied on May 15, 1946. (R. 184).

3
QUESTIONS PRESENTED

(1) As the United States in its pleadings alleged that petitioner in 1932 ascertained that its total recovery from National Bank and its stockholders would be less than the principal debt due from National Bank, did the Circuit Court of Appeals properly base its affirmance on petitioner's failure to prove the probable amount which could be recovered by it from National Bank and its stockholders? Petitioner contends that this issue, having been excluded by the pleadings, was not available for consideration by the Circuit Court of Appeals.

(2) Did the Circuit Court of Appeals, in affirming the judgment of the District Court upon an issue of fact excluded by the pleadings, err in failing to remand the case to the District Court to allow petitioner the opportunity to establish before that court by other evidence additional facts to rebut this new and unexpected issue? Petitioner contends that even if the issue as to ascertainment could properly be considered, the Circuit Court of Appeals should at the very least have remanded the case to the District Court to take additional evidence thereon, since in the present state of the case, the petitioner has never been allowed the opportunity to present evidence on the issue raised for the first time by the opinion of the Circuit Court of Appeals.

4
REASON RELIED ON FOR THE ALLOWANCE OF THE WRIT

The reason relied on for the allowance of the writ is that the Circuit Court of Appeals so far departed from the accepted and usual course of judicial proceedings as to call

for an exercise of the power of supervision of this Honorable Court.

(1) The Circuit Court of Appeals based its affirmance of the judgment of the District Court upon a statement as of fact—i.e. the petitioner's failure in 1933 and 1934 to ascertain the recovery to be had from National Bank's stockholders. Since the answer filed by respondent in the District Court "specifically avers" that petitioner made such an ascertainment as early as 1932, the petitioner properly refrained from introducing evidence to establish the fact before the District Court, and the Circuit Court of Appeals could not properly base its opinion on an assertion that the facts were not as alleged by both parties in their pleadings before the District Court. *Helvering v. Wood,* (1940), 309 U.S. 344; *General Utilities and Operating Co. v. Helvering,* (1935), 296 U.S. 200; *Helvering v. Salvage,* (1936), 297 U.S. 106; *cf. Minnich v. Gardner,* (1934), 292 U.S. 48. See *LeTulle v. Scofield,* (1940), 308 U.S. 415, at p. 416. See also, *Rules of Civil Procedure for the District Courts of the United States,* Rule 8 (d).

(2) Even if the Circuit Court of Appeals had authority to consider the ground upon which it affirmed the judgment of the District Court, then, since its action was based on a question of fact which was not raised in the District Court and upon which the petitioner therefore has never had an opportunity to present evidence, the Circuit Court of Appeals erred in affirming the judgment below in that, under such circumstances, the petitioner would be entitled to a new trial and such an opportunity. *Helvering v. Richter,* (1941), 312 U.S. 561; *Hormel v. Helvering,* (1941), 312 U.S. 552; *Helvering v. Gowran,* (1938), 302 U.S. 238.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari may issue out of and under the seal of this Honorable Court directed to the United States Circuit

Court of Appeals for the Fifth Circuit commanding said court to certify and send to this court on a day certain, to be therein designated, a full and complete transcript of the record of all of the proceedings in the Circuit Court of Appeals in said cause styled *"Ensley Bank and Trust Company, appellant, v. United States of America, appellee,"* No. 11,465 on its docket, to the end that said cause may be reviewed and determined by this court as provided by Section 240 of the Judicial Code, as amended.

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LEE C. BRADLEY, JR.
WHITE, BRADLEY, ARANT & ALL
Of Counsel

NO._____

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1946

ENSLEY BANK & TRUST COMPANY, *Petitioner,*

vs.

UNITED STATES OF AMERICA, *Respondent.*

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I
THE OPINIONS OF THE COURTS BELOW

The District Court's findings of fact and conclusions of law are printed at pages 92 through 110 of the Record. The District Court did not write an opinion. The opinion of the Circuit Court of Appeals is printed at page 174 of the Record, and is reported in 154 F. (2d) 968.

II
SPECIFICATION OF ERRORS

1. Since respondent did not raise by its pleadings, evidence, argument or otherwise the defense upon which the Circuit Court of Appeals affirmed the judgment of the District Court, the Circuit Court of Appeals erred in considering such defense and in basing its judgment thereon.

2. The Circuit Court of Appeals erred in affirming the judgment of the District Court without affording petitioner the opportunity to establish before the District Court by new evidence additional facts to disprove the new theory upon which the Circuit Court of Appeals based its judgment.

III

Applicable provisions of the statute and of the regulations are set out in Appendix A.

IV

ARGUMENT

POINT A

The Circuit Court of Appeals based its affirmance of the judgment of the District Court upon a statement as of fact—i.e. the petitioner's failure in 1933 and 1934 to ascertain the recovery to be had from National Bank's stockholders. Since the answer filed by respondent in the District Court "specifically avers" that petitioner made such an ascertainment as early as 1932, the petitioner properly refrained from introducing evidence to establish the fact before the District Court, and the Circuit Court of Appeals could not properly base its opinion on an assertion that the facts were not as alleged by both parties in their pleadings before the District Court.

The United States' pleading in the District Court asserted that petitioner *in 1932* ascertained a loss on National Bank's debt when both the pledged assets and the National Bank stockholders' liability were considered. (R. 5-6; 46). As will hereinafter appear, the petitioner in both courts below based its case on the proposition that, since there were only those two sources from which it might have received payment of National Bank's principal debt and of the interest thereon, it necessarily ascertained an *additional*

loss in 1933 and 1934 when it applied collections on the pledged assets to payment of its claim for interest. For, in so doing, petitioner necessarily reduced still further the already inadequate funds available for payment of National Bank's principal debt.

As has been demonstrated above, counsel for the United States did not at any time raise the issue of ascertainment. Counsel for the United States urged that there was no debt, but rather a purchase of a capital asset. In making that argument, counsel for the United States necessaily took the position that petitioner ascertained in 1932 that its recovery from all sources would be less than the amount of National Bank's debt. For otherwise there would have been no room for the contention that petitioner purchased a capital asset at a cost equal to the difference between such anticipated recovery and the amount of that debt. In other words, counsel for the United States based their entire case in both courts below upon the premise that petitioner ascertained a loss in the transaction in 1932, and purchased National Bank's good will for the amount of that loss. The District Court rendered its judgment on that theory.

In the alternative, counsel for the United States argued that, even if there had been a debt, nevertheless no deduction for partial worthlessness was available since petitioner was alleged to have been a "guarantor," and since the obligation of National Bank was alleged not to have matured at the time the deductions were claimed.

On this state of the record, the Circuit Court of Appeals decided the "Capital Asset" issue in petitioner's favor but held against petitioner on the ground that there had been no ascertainment of partial worthlessness during the years for which the deduction was claimed.

Your petitioner prays for the writ on the ground that the issue as to ascertainment was not properly raised in this

case, and, therefore, that such issue was not available for consideration by the Circuit Court of Appeals.

In *General Utilities and Operating Company v. Helvering,* (1935), 296 U.S. 200, the corporation had declared a dividend of stock in another company. The corporation's stockholders later sold at a profit the stock received by them as such dividend. The issue was whether or not the corporation was taxable on the profit received on that sale of the stock. Before the Board of Tax Appeals, the Commissioner urged only that the corporation actually declared a cash dividend payable in stock. In the Circuit Court of Appeals the Commissioner raised the additional argument that the stockholders, in effecting the sale, were in reality acting as agents of the corporation. This court held the second ground not available either to the Commissioner or to the Circuit Court of Appeals, saying:

> "The second ground of objection, although sustained by the court, was not presented to or ruled upon by the Board. The petition for review relied wholly upon the first point; and, in the circumstances, we think the court should have considered no other. Always a taxpayer is entitled to know with fair certainty the basis of the claim against him. Stipulations concerning facts and any other evidence properly are accommodated to issues adequately raised."

This court has reaffirmed the principle that new issues may not be raised by the United States for the first time on appeal in two later decisions. *Helvering v. Salvage,* (1936), 297 U.S. 106; *Helvering v. Wood,* (1940), 309 U. S. 344.

This petition raises an even more obvious case for the application of that principle. For here, counsel for the United States have *never* argued the issue as to ascertainment. That issue was raised by the Circuit Court of Ap-

peals on its own motion, without the benefit of evidence on the point, and without any argument by counsel for either side.

The Circuit Court of Appeals, in basing its decision on an issue not presented to it for consideration, departed from the accepted course of judicial proceedings. This Honorable Court should issue its writ, as prayed herein, in an exercise of its power of supervision.

POINT B

Even if the Circuit Court of Appeals had authority to consider the ground upon which it affirmed the judgment of the District Court, then, since its action was based on a question of fact which was not raised in the District Court and upon which the petitioner therefore has never had an opportunity to present evidence, the Circuit Court of Appeals erred in affirming the judgment below in that, under such circumstances, the petitioner would be entitled to a new trial and such an opportunity.

This court has indicated that, in some circumstances, the United States will not be precluded from raising a new issue in an appellate court, but that, if such a new issue is raised, the case should be remanded to give the taxpayer an opportunity to present additional evidence upon the new issue.

This petitioner filed in the Circuit Court of Appeals a petition for rehearing in which, among other things, it was urged that the case should be remanded to the District Court to permit it to introduce new evidence showing that the loss was ascertained when *both* collections on the pledged assets and from the National Bank stockholders were considered.

In *Hormel v. Helvering,* (1941), 312 U.S. 552, and in *Helvering v. Richter,* (1941), 312 U.S. 561, where short term trusts were involved, this court held that the case should be remanded for additional evidence where the United States raised for the first time on appeal an issue as to taxability of the income to the grantor under Section 22 (a) of the Internal Revenue Code. In *Hormel v. Helvering, supra,* the court said:

> "Ordinarily an appellate court does not give consideration to issues not raised below. For our procedural scheme contemplates that parties shall come to issue in the trial forum vested with authority to determine questions of fact. This is essential in order that parties may have the opportunity to offer all the evidence they believe relevant to the issues which the trial tribunal is alone competent to decide; it is equally essential in order that litigants may not be surprised on appeal by final decision there of issues upon which they have had no opportunity to introduce evidence. And the basic reasons which support this general principle applicable to trial courts make it equally desirable that parties should have an opportunity to offer evidence on the general issues involved in the less formal proceedings before administrative agencies entrusted with the responsibility of fact finding. Recognition of this general principle has caused this Court to say on a number of occasions that the reviewing court should pass by, without decision, questions which were not urged before the Board of Tax Appeals. . . ."

Your petitioner argues that since the issue as to ascertainment was not raised or considered in the District Court, it was not available either to the United States on appeal, or to the Circuit Court of Appeals. There is no circumstance justifying the failure to raise the issue in the District Court such as was present in *Helvering v. Hormel, supra.* But even if such circumstances do exist in this case,

at the very least the Circuit Court of Appeals should have remanded the case to the District Court so as to afford your petitioner an opportunity to present evidence on the new and unexpected issue.

CONCLUSION

It is respectfully submitted that this case is such as to call for the exercise by this Honorable Court of its supervisory powers, and we, therefore, respectfully pray that the petition for writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit be granted.

Respectfully submitted,

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Of Counsel

APPENDIX "A"

The applicable statutes are the Revenue Act of 1932, c. 209, 47 Stat. 169, and the Revenue Act of 1934, c. 277, 48 Stat. 680. The deductions claimed are allowed by Section 23 (j) of the 1932 Act and by Section 23 (k) of the 1934 Act, which control the years 1933 and 1934 respectively. The sections in the two acts are identical and read as follows:

> Sec. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income, there shall be allowed as deductions:
>
> "(j) or (k) BAD DEBTS. Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction."

The relevant portions of Treasury Regulations 77, promulgated under the Revenue Act of 1932, and of Treasury Regulations 86, promulgated under the Revenue Act of 1934, are identical. Article 191 of Regulations 77 provides in part as follows:

> "Art. 191. BAD DEBTS. * * * Where all the surrounding and attending circumstances indicate that a debt is worthless, either wholly or in part, the amount which is worthless and charged off or written down to a nominal amount on the books of the taxpayer shall be allowed as a deduction in computing net income. * * * Before a taxpayer may charge off and deduct a debt in part, he must ascertain and be able to demonstrate, with a reasonable degree of certainty, the amount thereof which is uncollectable. * * * In determining whether a

debt is worthless in whole or in part the Commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor. Partial deductions will be allowed with respect to specific debts only.

"Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. * * *"